

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Firebaugh, Chavez, & Wesson Analyst: Marion Mann DeJong Bill Number: AB 923

Related Bills: See Legislative History Telephone: 845-6979 Amended Date: May 1, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Provided Health Coverage Credit/Farmworkers

SUMMARY

This bill would create a credit for employers who provide health care coverage for their agricultural employees. The credit would be allocated from revenue raised by repealing certain sales tax exemptions.

This analysis will not address the bill's changes to the Sales Tax Law or the allocation to be made by the Employment Development Department (EDD) since they do not impact the department.

SUMMARY OF AMENDMENTS

The April 24, 2003, amendments deleted the provisions of the bill as introduced and inserted the provisions discussed in this analysis.

The May 1, 2003, amendments made the following changes:

- Clarified that health care coverage costs for the employee's dependents are included in the computation of the credit.
- Increased the aggregate amount available for the credit by EDD's cost to administer the program.
- Added a provision allowing EDD to charge taxpayers a fee for applying for the credit.
- Added an annual reporting requirement.

PURPOSE OF THE BILL

According to the author and sponsors, the purpose of this bill is to expand agricultural employees' access to health insurance.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. However, the bill specifies that it would apply to taxable years beginning on or after January 1, 2004.

POSITION

Pending.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

5/15/03

Summary of Suggested Amendments

Amendments are needed to resolve the department's concerns regarding the penalty. See "Implementation Considerations" below. In addition, technical amendments are provided. See "Technical Considerations" below. Department staff is available to assist the author with amendments.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. For example, an employer would be allowed a deduction for the cost of health care coverage provided to employees.

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Currently, there are no federal or state credits for paying for an employee's health care coverage. Prior state law would have provided a small-employer health coverage tax credit (SB 2260, Stats. 1988, Ch. 1521). However, the credit was repealed before becoming operative.

THIS BILL

This bill would repeal the sales tax exemptions on diesel fuel, racehorse breeding stock, and farm equipment. Revenue raised from repealing these sales tax exemptions plus EDD's costs to administer the program would be used to provide a tax credit allocated by EDD to employers that provide health care coverage to their agricultural employees. The Board of Equalization would estimate the amount of revenue raised annually and inform EDD of that amount so that a credit in that amount plus EDD's cost to administer the program can be allocated to taxpayers in the form of a franchise or income tax credit.

To be eligible for the credit, the taxpayer must either employ agricultural employees directly or be a labor contractor that employs agricultural employees for use by farmers and:

- Provide those employees with health care coverage and pay at least 80% of the cost of that coverage.
- Apply to the EDD for the credit by January 31, following the close of the taxable year.

The health care coverage must be equivalent to either of the following:

- A health care service plan under the Knox-Keene Health care Services Plan Act of 1975.
- A plan that would qualify under the Employee Retirement Income Security Act of 1974 and provides substantially the same minimum benefits as required under the Knox-Keene Health Care Service Plan Act of 1975.

EDD would do all of the following:

- Determine the amount of allocated credit for each taxpayer who applied by multiplying the revenue raised by repealing the sales tax exemptions plus EDD's costs to administer the credit by a ratio of the amount the taxpayer paid for health care coverage for agricultural employees and their dependents to the total amount all taxpayers who applied for the credit paid for health care coverage.
- Provide written notification of the credit amount to each taxpayer by February 28th of each calendar year.
- Provide an annual list to the Franchise Tax Board (FTB), preferably on a computer readable form.

Unused credit amounts could be carried forward for six years. Fraudulent credit claims would be punishable by a criminal penalty of up to one year in jail and a fine of up to \$60,000.

EDD would be allowed to charge each taxpayer applying for the credit a fee to cover the costs of administering the credit.

FTB and EDD would report annually to the Legislature regarding the utilization of this tax credit.

IMPLEMENTATION CONSIDERATIONS

Since EDD would allocate the credit among taxpayers, implementation of the credit would not significantly impact the department. Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. In addition, this bill would require an annual report to the Legislature.

Department staff has identified concerns regarding the criminal penalty for fraudulent credit claims. Since this penalty is based upon the criminal penalty for tax evasion administered by FTB, it appears that FTB is to assess the penalty. However, EDD would have the information required for determining if a penalty is warranted. Amendments are needed to clarify how the penalty is to be implemented and which department is responsible for assessing the penalty and resolving any disputes arising from its assessment.

TECHNICAL CONSIDERATIONS

Amendments 1 through 6 would clarify that a reference to "the department" is referring to EDD rather than FTB.

LEGISLATIVE HISTORY

AB 293 (Daucher, 2003/2004) would allow full-time employees of small businesses to contribute up to five hours a week of paid, tax-free, overtime towards the employees' share of health care coverage costs. AB 293 is in the Assembly Committee on Health.

AB 790 (Maldonado, 2001/2002), 2208 (Frusetta, 1999/2000), and AB 1172 (Frusetta, 1999/2000) would have created an employer tax credit for providing health care or health insurance to farmworker employees. AB 790 and AB 1172 failed passage out of the house of origin before the constitutional deadline for two-year bills. AB 2208 failed to pass out of the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed because of similarities to California's economy, business entity types, and tax laws. None of these states provide a credit comparable to the credit allowed by this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Discussion

The revenue impact of this measure, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 923 Tax Years Beginning After 1/1/2004 Enactment Assumed After June 30, 2003 \$ Millions				
	2004-5	2005-6	2006-7	2007-8
Revenue Impact*	-\$50	-\$65	-\$65	-\$70

* The above estimates do not consider EDD's cost of administering this bill. Department staff will revise this revenue estimate when EDD provides estimates of their costs.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The Board of Equalization has indicated that the repeal of the sales and use tax provisions as proposed by this bill would increase the sales and use tax revenues by \$79 million. This bill is intended to return this amount to the qualified taxpayers via franchise or income tax credits. It is assumed that only 70% of the taxpayers would have sufficient tax liability to use the credits. The first year impact considers the fact that some fiscal-year taxpayers would not be able to use the full amount of credit until after June 30, 2005. The unused credits would be carried forward to the succeeding six years.

The first year impact was arrived at as follows.

Aggregate amount of the credits due to the repeal	\$80,000,000
Times the percent of positive income taxpayers	× 70%
Equals the qualified credit amount	<u>\$56,000,000</u>
Minus the amount due to late fiscal filers	<u>– \$6,000,000</u>
Equals the first-year impact	\$50,000,000

ARGUMENTS/POLICY CONCERNS

- This bill does not contain a sunset date. Sunset dates generally are provided to allow periodic review of credits by the Legislature.
- Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense. Providing both a credit and allowing the full amount to be deducted would provide a double benefit for that cost. On the other hand, making an adjustment to deny or reduce the deduction in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 923
As Amended May 1, 2003

AMENDMENT 1

On page 4, line 23, delete "the department," and insert:
that department,

AMENDMENT 2

On page 4, line 38, delete "the department's" and insert:
that department's

AMENDMENT 3

On page 6, line 2, delete "toward the" and insert:
toward that

AMENDMENT 4

On page 6, line 39, delete "the department," and insert:
that department,

AMENDMENT 5

On page 7, line 14, delete "the department's" and insert:
that department's

AMENDMENT 6

On page 8, line 19, delete "toward the" and insert:
toward that